

VAT-OVDPs

Fixed income review

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Last week the government of Ukraine approved the parameters of the earlier-announced government bonds issue. These bonds will be used to repay the governments outstanding VAT debts to economic entities.

The register of the companies to which the state must refund VAT was prepared as of June 1, 2010. The expected amount of the debt, and the corresponding planned volume of the OVDP issue, amounts to 20 bln hryvnia.

The OVDP's par value is 1 thsd hryvnia and the bond's redemption date will be in five years. The bonds will have a coupon payable every six months, the amount of which shall be calculated based on a coupon yield of 5.5% p.a. In addition, throughout the entire circulation period, 10% of its par value shall be paid to the holder, i.e. 100 hryvnia per bond.

Thus, the coupon yield will be accrued every six months during the circulation period based on their amortization cost, in parallel with a payment of some part of the nominal.

Most of the companies that will receive these bonds as compensation for VAT refunds owed by the state are in acute need for cash to replenish their working capital. Thus, it can be expected that they will sell the bonds with a good discount shortly after crediting to their respective accounts. This will be also facilitated by the fact that currently, lending to corporations is still frozen and banks prefer to invest excess liquidity into more reliable instruments, particularly in OVDPs.

The overall volume of OVDPs currently in circulation amount to about 105 bln hryvnia. Of this amount, bonds worth nearly 69 bln hryvnia (or 65% of the total volume) are held by the National Bank of Ukraine, and the remaining 36 bln hryvnia can more or less be considered as free float. This means that, for the secondary market to absorb the new 20 bln hryvnia in state bonds in a short period of time, the VAT bonds' yields must significantly increase (by 400-500 b.p.) relative to the current yield curve.

Taking into consideration the expected attractive yield levels and additional advantages in terms of the gradual repayment of the par value, we expect that both the demand for VAT bonds and their liquidity will be high.

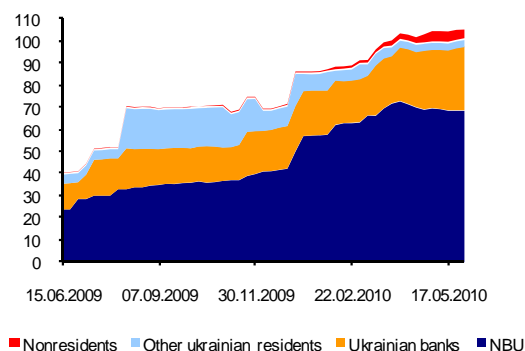
Information about the bond issue

Currency	UAH
Par value	1000
Volume	≈20 bln hryvnia
Coupon	5.5%
Coupon payment	Twice a year
Call/put option	10% of par value every 6 months
Redemption	5 years

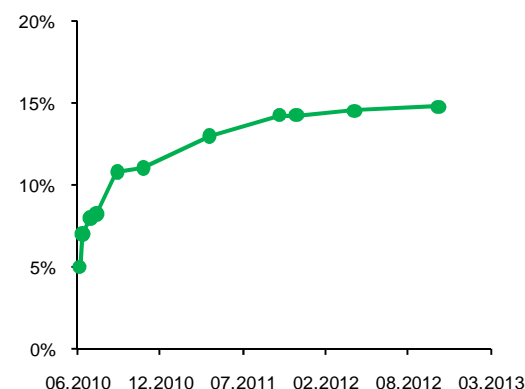
Agency Rating (national/international scale)

Agency	Rating
Standard & Poor's	B/uaA+
Moody's	B2/-
Fitch	B-/AA-(ukr)

OVDP holders, bln hryvnia.



OVDP yield curve



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